

Message Text

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FM AMEMBASSY PARIS
TO SECSTATE WASHDC 0630
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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC); REVIEW OF YUGOSLAVIA, APRIL 10

REF: (A) EDR(78)8; (B) PARIS 11458

1. SUMMARY: SECRETARIAT DRAFT SURVEY PROVIDED EXCEL-
LENT BASIS FOR EDRC DISCUSSION OF YUGOSLAV ECONOMY,
WHICH BY AND LARGE ENDORSED SECRETARIAT'S ANALYSIS AND
RECOMMENDATIONS. YUGOSLAV DELEGATION ATTEMPTED TO
EXPLAIN ITS LOW 1978 IMPORT (THUS CURRENT DEFICIT) FORE-
CAST AS WELL AS EFFICIENCY OF ITS PECULIAR INSTITUTIONAL
SYSTEM FOR ALLOCATING CAPITAL FUNDS, BUT DID NOT MEET
WITH TOTAL SUCCESS. YUGOSLAV FRUSTRATION WITH EUROPEAN
"PROTECTIONIST" TENDENCIES WAS EVIDENT AND PROVIDED CON-
VENIENT, EVEN IF SHAKY, EXPLANATION FOR WEAK EXPORT PER-
FORMANCE. YUGOSLAV DELEGATION TOOK PAINS TO STRESS
IMPORTANCE OF EDRC REVIEW TO YUGOSLAV POLICY-MAKERS, A
FACT WITNESSED TO BY STRONG DELEGATION HEADED BY BOGOEV,
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GOVERNOR OF THE CENTRAL BANK. MISSION APPRECIATED PARTI-
CIPATION OF AMEMBASSY BELGRADE E/C OFFICER MONTGOMERY IN
EXAMINATION. END SUMMARY

2. TRENDS AND FORECAST: YUGOSLAV DELEGATION DESCRIBED
1977 ECONOMIC PERFORMANCE AS GENERALLY FAVORABLE, CITING
HIGH GROWTH RATE (7 PERCENT), STRONG ADVANCE IN INDUSTRIAL

PRODUCTION (9 PERCENT), FAVORABLE DISTRIBUTION OF DEMAND, WITH SHIFT TO PRODUCTIVE INVESTMENT (UP 9.5 PERCENT) PLUS 4.4 PERCENT INCREASE IN EMPLOYMENT. INFLATION AND BALANCE OF PAYMENTS WERE PROBLEM AREAS, BUT ARE NOW, ACCORDING TO YUGOSLAVS, BEHAVING MORE ACCEPTABLY. DELEGATION NOTED THAT (A) CURRENT ACCOUNT DEFICIT FOR 1976/77 (COMBINED) IS WITHIN PLAN LEVEL, (B) SPECIAL FACTORS INFLATED 1977 IMPORTS (FOOD TO COUNTERACT POOR 76/77 CROP, EQUIPMENT TO COMPLETE SEVERAL MAJOR PRIORITY PROJECTS, STOCK RECONSTITUTION, J-CURVE EFFECT), (C) FOREX RESERVES ARE SUFFICIENTLY HIGH TO WEATHER TEMPORARILY INFLATED DEFICITS, AND (D) COMPETITIVENESS RESTORED DUE TO DOLLAR DEPRECIATION AT END 1977. ON BASIS THESE FACTORS, YUGOSLAV DELEGATION FELT THAT 1978 DEFICIT COULD BE HELD TO \$1.2 BILLION PER PLAN. DELEGATION ALSO EXPLAINED THAT SECRETARIAT INFLATION STATISTICS FOR 1978 WERE MISLEADING SINCE VIRTUALLY ALL INCREASES IN RETAIL PRICES ARE TRACEABLE TO ADMINISTRATIVE FACTORS (ENERGY COST INCREASES, ABSOLUTION OF FOOD SUBSIDIES) AND LITTLE, IF ANY, PRESSURE IS BEING EXERTED ON MARKET SIDE. ON BASIS PRODUCER PRICES, YUGOSLAVS PRODUCED STATISTICS WHICH INDICATED DOWNWARD TREND IN PRICES SINCE START OF 1978. YUGOSLAV DELEGATION REPORTED THAT TRENDS TO DATE IN 1978 DO NOT REQUIRE ANY CHANGE IN 1978 TARGETS.MMGL3

3. ECONOMIC POLICY: MONETARY -- YUGOSLAVS FIELDLED SEV-LIMITED OFFICIAL USE

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ERAL QUESTIONS ON ROLE OF INTEREST RATE IN RESOURCE ALLOCATION BY REMINDING COMMITTEE THAT INTEREST RATE PER SE IS NOT A DECISIVE VARIABLE IN YUGOSLAV ECONOMY. ALLOCATION OF INVESTMENT FUNDS, ALTHOUGH MORE DECENTRALIZED THAN IN MOST COMMUNIST STATES, IS DETERMINED BY (A) PRIORITY PROJECTS AND (B) DISTRIBUTION BY ENTERPRISE-OWNED BANKS TO COMPETING PROJECTS ACCORDING TO THEIR RATES OF RETURN ("INTEGRAL INCOME"). DELEGATION ANNOUNCED PLANS FOR ENTERPRISE INTERFINANCING SCHEMES (BY POOLING LENDABLE FUNDS), WHICH WOULD REQUIRE RETURN OF REAL RESOURCES TO LENDER, EFFECTIVELY APPLYING ZERO REAL INTEREST RATE VS. NEGATIVE REAL RATE NOW IN EFFECT THROUGH BANKING SYSTEM. ON MONETARY AGGREGATES, DELEGATION STATED THAT FLUCTUATIONS IN CURRENT ACCOUNT HAD MADE CONTROL OF MONEY SUPPLY DIFFICULT, BUT THAT 1977 PERFORMANCE AND 1978 TRENDS WERE ACCORDING TO EXPECTATIONS.

4. EMPLOYMENT: CITING UNEMPLOYMENT AS SERIOUS LONG-TERM PROBLEM, YUGOSLAV DELEGATION NOTED PLAN TO CREATE 800,000 NEW JOBS BY 1985, WHICH WOULD MEET REQUIREMENTS OF NEW LABOR FORCE ENTRANTS AND PROVIDE FOR SOME ABSORPTION OF CURRENTLY UNEMPLOYED AND JOB SWITCHERS, ESPECIALLY FROM

AGRICULTURE. SPECIAL MEASURES TO PROMOTE "SMALL ECONOMY"
ARE EXPECTED TO HELP CREATE JOBS. PRESSURE ON NON-
AGRICULTURAL JOB MARKET IS EXPECTED TO CONTINUE UNTIL
CURRENT 35 PERCENT ENGAGED IN AGRICULTURE IS REDUCED TO
20 PERCENT. NET INWARD MIGRATION IS EXPECTED TO CONTINUE
TO 1985, BUT SHOULD NOT BE CRITICAL. YUGOSLAV DELEGATION
STATED THAT INSUFFICIENT CAPITAL WAS PRIMARY CAUSE OF
UNEMPLOYMENT, THUS UNDERLINING NEED FOR HIGH NET INVEST-
MENT.

5. INCOMES: IN RESPONSE TO SECRETARIAT FINDING THAT
STRONG INCOMES POLICY IS NEEDED TO HOLD DOWN NOMINAL WAGE
TRENDS THUS AIDING COMPETITIVENESS, DELEGATION STATED
THAT YUGOSLAV INCOMES POLICY WAS "EXCELLENT IN CONCEPT"
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BUT DIDN'T ALWAYS SHOW DESIRED RESULTS, PRIMARILY DUE
TO BREAKDOWN IN DISCIPLINE BELOW NATIONAL LEVEL WHERE
AGREED CRITERIA ARE NOT RESPECTED. YUGOSLAVS DID NOT
GO INTO ANY PLANS TO IMPROVE DISCIPLINE IN THIS REGARD

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6. EXCHANGE RATE AND TRADE: DELEGATION STATED THAT
YUGOSLAVIA FOLLOWS "REAL EXCHANGE RATE" POLICY WHEREBY
IT ATTEMPTS TO FOLLOW REAL RATHER THAN NOMINAL RATE RELA-

TIONSHIPS. PRESENT PEG TO DOLLAR HAS ACCEPTABLY MAINTAINED COMPETITIVENESS ACCORDING TO YUGOSLAV CALCULATIONS, ALTHOUGH KEY "REAL RATES" (WITH FRG, ITALY, SWITZERLAND, AUSTRIA) ARE UNDER CONSTANT REVIEW. ON TRADE, YUGOSLAVS CITED PROTECTIONIST TREND IN THEIR MAJOR MARKETS AND/OR FOR KEY EXPORT PRODUCTS (EC, TEXTILES, STEEL, CHEMICALS) AS PRINCIPAL CAUSE OF EXPORT WEAKNESS. THEY ARE SEEKING TO NEGOTIATE AWAY SUCH BARRIERS AND ARE ALSO ACTIVELY PROMOTING NEW "MORE OPEN" MARKETS, ESPECIALLY IN "DOLLAR ZONE," EASTERN EUROPE, AND LDC'S. YUGOSLAV DEL DENIED THAT CUSTOMS REIMBURSEMENT WAS DE FACTO EXPORT SUBSIDY, ADDING THAT FORMER EXPORT PROMOTION FUND IS BEING PHASED OUT TO BE REPLACED, ACCORDING TO BOGOEV, BY A SPECIALIZED BANK "FASHIONED ALONG LINES OF EXIM, COFACE, ETC." SHIFT OF TRADE BALANCE RESPONSIBILITY TO REPUBLICS AND "COMMUNITIES OF INTEREST" WAS PASSED OVER QUICKLY WITH COMMENTS THAT IT WAS ANOTHER STEP TO BRING RESPONSIBILITY CLOSER TO PRIMARY ECONOMIC ACTION. BASIC DISAGREEMENT BETWEEN SECRETARIAT AND YUGOSLAVS ON REASONS FOR LIMITED OFFICIAL USE

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EXPORT WEAKNESS WENT UNRESOLVED. DELEGATION SEEMED NOT TOO CONCERNED ABOUT CURRENT ACCOUNT DEFICIT ("NORMAL FOR DEVELOPING COUNTRY") AND PROJECTED \$5.5 BILLION INCREASE IN EXTERNAL DEBT OVER PERIOD 1976-80 (\$9.5 BILLION OUTSTANDING END 1977) WITH DEBT SERVICE RATIO EXPECTED TO REMAIN WELL BELOW 20 PERCENT. ACCORDING DELEGATION, VIRTUALLY ALL DEBT IS "LONG-TERM" EXPORT CREDIT FINANCING. GIVEN TRENDS TO DATE, DELEGATION SAW NO REASON IMMEDIATELY TO CUT BACK ON CONSUMER IMPORTS TO PROTECT 1978 BALANCE OF PAYMENTS, ADDING THAT WHILE POTENTIAL DANGER EXISTS FROM EXCESSIVE CONSUMER GOODS IMPORTS, IT IS NOT POLITICALLY ACCEPTABLE TO RESTRAIN PRIVATE CONSUMPTION AS LONG-TERM POLICY.

7. CONCLUSIONS: EDRC WAS LESS SANGUINE THAN YUGOSLAVS ON BOP AND INFLATION OUTLOOK FOR 1978, ESPECIALLY SINCE STRONG DOMESTIC GROWTH WOULD EXACERBATE PRICE PRESSURES, ENCOURAGE IMPORTS AND DISCOURAGE EXPORT EFFORT. COMMITTEE DOUBTED REALISM OF YUGOSLAV PROJECTION OF ZERO IMPORT GROWTH IN 1978, DESPITE SPECIAL FACTORS IN 1977. YUGOSLAVS AGREED WITH SECRETARIAT'S POLICY RECOMMENDATIONS (PER REFDOC) IN EVENT SERIOUS BOP PROBLEMS AROSE, BUT DIDN'T AGREE THAT PROBLEM WAS IMMINENT. IN MEDIUM TERM, EDRC WAS SKEPTICAL THAT YUGOSLAV AUTHORITIES HAD ADEQUATE POLICY INSTRUMENTS TO REACH THEIR OBJECTIVES IN SYSTEM OF "DECENTRALIZED SOCIALISM." FOR EXAMPLE, COMMITTEE WAS NOT CONVINCED BY YUGOSLAV EXPLANATION THAT YUGOSLAV SYSTEM TO ALLOCATE INVESTMENT FUNDS WOULD AVOID WASTE AND INEFFICIENT UTILIZATION OF THOSE FUNDS. ABILITY TO CON-

TROL COST PRESSURES ALSO QUESTIONED, GIVEN RECENT INEF-
FECTIVE INCOMES POLICY. THROUGHOUT LONG GIVE-AND-TAKE
WITH COMMITTEE, FREQUENT REFERENCES WERE MADE TO SPECIAL
INSTITUTIONAL ARRANGEMENTS IN YUGOSLAVIA AS EXPLANATIONS
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FOR DEVIATIONS FROM STANDARD ECONOMIC ANALYSIS, CONCLU-
SIONS AND POLICY. SALZMAN

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